



## Condos vs. Co-ops: What is the difference?

By Joseph Himali, CRS, GRI, Principal Broker, Best Address® Real Estate, LLC

Article © 1999-2006, Best Address® Real Estate, LLC, All Rights Reserved

This is one of the most common questions that Realtors who work in the city get asked. There is no way to tell a condo from a co-op just by visiting the building and looking around. They don't look, smell, feel or sound different. And if you live in either, you would never notice any differences in your daily life.

The big difference is how the property is legally owned. The consequences of that difference are important. To understand the differences, it's important to understand the three basic ways property is owned in the United States: fee simple, condominium and cooperative.

Fee simple is a legal term for solely owning all of your own property. For most Americans, this is what they think owning real estate is all about. A single family house is the most common example of fee simple real estate. You own your home, the land it sits on and you have complete control over it. If the roof blows off and you don't want to fix it, you don't have to. Your home is your castle.

Fee simple is a great way to own real estate when there is plenty of space to build on. But in a city, most people cannot afford to own a single family home on a quarter-acre because the land is too expensive. In order to afford living in a city, people often join together and own a shared interest in a common building. The most common form of this ownership is a condominium, but cooperatives are another alternative.

Before you can understand the differences between condos and co-ops, you must first understand how each works so you can compare the two. Condominiums are easier to understand than cooperatives, so let's start there.

### How Condominiums Work

Let's take a hypothetical condominium in the city. It is four stories tall, there is one unit on each floor, and all the units are the same size. Also, the building has a circular driveway and a stairway that leads from the ground floor to each unit.

If you were to buy the top floor condominium in our hypothetical building, you would own your unit, the walls, floors and ceilings and everything inside it. You can do what you wish inside your unit as long as it does not affect the other condominium unit owners. For instance, you could not drill holes in your floor of your bathroom to let water pour down onto your neighbor below.

### Common Elements

When you own a condo, you also own a percentage share of "common elements."

What are common elements? These are all the parts of a building that are used by all the owners but are not directly owned by them. For example: the roof, hallway and driveway.

In our hypothetical building, each condominium dweller owns his or her unit completely *and* each shares a 25% ownership of the common elements. (That is 25% of the hall, roof, stairs, driveway, etc.)

While only the top floor unit has the roof attached to it, all of the people in the building enjoy the benefit of the roof because it keeps rain out of the whole building. If the roof leaks, the owner of the top floor unit does not have to pay for a new roof by him or herself because he or she is not the only one benefiting from the roof. All the unit owners would pay an equal portion of the cost of the roof because they all use the roof.

## The Condominium Fee

Unlike a house that one person owns by himself or herself, in condominiums there is a condominium fee that all owners pay. Why is there a condominium fee, anyway? Many people unfamiliar with condos complain that it is just like paying rent! But nothing could be further from the truth.

The fee is usually assessed to each unit proportionately to the unit's size. Thus, a large unit will pay more in condominium fees than a small unit. A condominium fee consists of up to four parts: a reserve fund, an operation fund and sometimes special assessments and utilities.

## Reserve Fund

The reserve fund is used to cover the cost of the expected replacement of the condominium's systems. When the condominium is created, a list of all the common elements is created. The list also shows the length of time that element lasts and how much it costs to replace that element.

Here is an example list using our hypothetical building:

<b>Element</b>	<b>Years of Service</b>	<b>Cost to Replace</b>
Roof	20	\$20,000
Water Heater	10	1,000
Carpeting	5	5,000
Fence	10	10,000
Copper Plumbing	100	100,000

Then the condominium figures out how much it will cost to cover all of these replacements over a set number of years. For example, the roof will need to be replaced 5 times over 100 years, and the water heater will have to be replaced 10 times in 100 years. In our example, if you do all the math, that gives the condominium a total cost of \$710,000 every 100 years.

It's a matter of simple division to figure out how much will need to be put aside to cover the cost of all of these repairs: \$710,000 divided by 100 years (\$7,100).

By this calculation, the condominium figures out how much needs to be put aside each year to cover all the replacements in the building. That cost is divided by the number of units in the building. So in our hypothetical condominium of 4 units (\$7,100 divided by 4 = \$1,775), each unit owner must put aside \$1,775 a year to cover his or her portion of the reserve fund. However, they don't have to pay that amount in one fell swoop. Rather, it's paid on a monthly basis. So, in our example \$1,775 is divided by the number of months in the year (12), and each unit owner will pay \$147.92 per month for reserves.

So, why pay reserves ahead of time? Reserves are collected ahead of time so that no one will be caught without the money to cover their portion when the time comes to make the replacement. By collecting the money up front there is always enough money to make the proper repairs as they are needed.

## Operation Fund

The second part of the condominium fee is the operation fund. The operation fund is used to cover the costs to operate the common elements of the condominium every month. For example, electricity to light the hallway, the salary of the employees at the front desk, heating the hallway, insurance for the building, etc.

These costs are estimated at the beginning of each year and those costs are then divided among the condominiums. The same mathematical formula is used.

If the building will have \$12,000 in estimated expenses, each unit will pay 25% of that amount in the year (\$3,000) and that figure is divided by 12, for the number of months in the year. Thus, each unit owner will pay \$250 per month for operating the building.

*Please note: Although the building has insurance for all the common elements, each unit owner must still buy insurance to cover their interior belongings.*

## Special Assessments

Sometimes there are unforeseen expenses in the condominium. For example, if a hurricane hits the building so hard that the roof is torn off five years before it was supposed to be replaced, the condominium can't wait five years to replace it. Usually insurance would pay for the expense, but what if the insurance doesn't cover the whole amount needed?

Usually the condominium will make a special assessment, which is a one-time charge to all the unit owners to cover this unexpected cost. The amount assessed is generally proportional to the unit's sizes. Special assessments are called "special" because they are not supposed to happen very often.

## Utilities

Sometimes, especially in older buildings, a condominium fee includes utilities that are used by individual unit owners. Water and sewer service are the most common type of utility included in condo fees, although heat, electricity, natural gas and even cable television is sometimes included.

The reason older buildings have some utilities included is because they were built before individual units in the building could be metered separately. The cost of utilities is usually divided by the percentage of ownership in the building, just like everything else in a condo fee.

Remember, when looking at a fee that seems especially high that it could include many utilities, which would not appear on a "lower" fee. That "lower" fee may not be such a bargain when you consider all the costs that you will pay for outside of the fee.

## Condominium Fee for Homeowners?

A condominium fee exists to run the building and protect all unit owners' interests. Sometimes Realtors hear people say, "If I owned my own house, I wouldn't have a condo fee, so why buy a condo?" The fact is that homeowners pay the same amount as condo owners; they just don't do it every month.

A roof will need to be replaced on a house; just the same way it does on a condo. But a house owner usually does not put aside money each month to cover the cost when it finally arrives. Then the homeowner gets a giant bill to replace the roof the day it is needed. That is why so many homes are in disrepair; the owners have not been putting aside money to cover their costs! The next time you're walking around, take a close look at single family homes. How many look like they are in desperate need of a paint job or some other exterior repair? The "condo fee" that the home owner has been avoiding for many years is now coming due.

No one likes to pay a condominium fee. Many times Realtors hear clients say, "It's the condo board. THEY impose the condominium fee on me." The condo board is comprised of other unit owners who also want the least expensive fee possible.

The unfortunate fact of life is that it costs money in order to keep a property in good shape. An owner either pays for it each month in a condo fee or as each item needs to be replaced.

## The Condominium Board

In order to assure that the best interest of the condominium is served, condominiums have an executive board with at least three members: a President, Treasurer and Secretary. Condominium owners elect the board. Usually, each owner has votes equal to the size of his or her unit; so large units have a more votes than small units.

The condominium board determines what the fees will be every year. Remember that the board members hate large fees as much as everyone else. So you can be assured that the fees will be as low as possible.

The board also settles disputes between unit owners. This protects the peace of the building as a whole. When two owners disagree about something in the building, the board will resolve the dispute according to the condominium rules.

## The Condominium Resale Package

When a prospective purchaser writes an offer to buy a condominium he/she assumes that everything is running properly in the building he/she is interested in. However, the buyer doesn't actually know what the rules are in the building or how much money the building has in reserve, or even whether the building is being sued.

Therefore, before a prospective buyer actually buys a condominium the buyer is given an opportunity to review the "resale package," (also called the "condo docs") which includes the rules of the building, a financial disclosure, the "investor ratio," and much more.

If any of these pieces are unacceptable to the prospective buyer, his or she has the opportunity to leave the sales contract without penalty. In the District of Columbia, the buyer has a non-waivable 3 (three) business-day review period after receiving the documents. During this period, the buyer has a right to cancel the contract without penalty. Please note, this is not a chance for a buyers to simply reconsider their purchase, or negotiate new terms! This is only an opportunity to make sure the building is as it appears to be.

Cooperatives sold with Realtors in Washington, DC also have a 3-business day period to review the resale package (or "Co-op Docs"). Interestingly, District law does not mandate that the seller give a buyer 3-business days to review the documents. However, it is part of the contract used by Realtors that the buyer have this review period.

## Investor Ratio

The investor ratio is a very important concept for prospective condo or cooperative unit owners to understand. If someone buys a condominium and lives in it, he or she is considered an "owner occupant." A condominium owner can also choose to rent out their condominium, in which case he or she is called an "investor owner." Every condominium strives to have the lowest investor ratio possible. A prospective buyer will find out what the ratio is when he or she gets the resale package.

Banks don't like to lend to buildings that have many investors because banks believe that renters will be less likely to maintain the building than owner occupants. If a building has more than 20% investors **some** banks will not lend into that building, and if a building has higher than 50% investors **most** banks will not lend into that building. So it is important to find buildings that have low investor ratios so that the condominium or cooperative will be easier to resell.

In addition, cooperatives are generally very restrictive than condos on an owners ability to rent his or her unit. The reason for the restriction is simple: If a co-op has more than 20% renters it can lose its tax status as a "primary residence" for the owners who do occupy their units. That's because the IRS has special rules for co-ops and if the IRS decides that the building is not a "primary residence" the owners will not be able to take their mortgage interest deductions!

## How Cooperatives Work

A cooperative is a non-profit corporation whose sole purpose is to own and operate one building or complex. When buyers choose to live in a cooperative, you may be surprised to learn that they do not buy any real estate! Instead, they buy shares of stock in the cooperative's corporation. Usually, the amount of stock they buy is proportionate to the size of the unit they are moving into. Then the corporation gives that buyer a lease or a permanent right to occupy the unit.

Ownership is the essential difference between condominiums and cooperatives.

## Cooperative Fees

A common misconception is that co-ops are more expensive than condos because their monthly fee seems higher. That's because, in general, co-op fees include two costs that condo fees don't – property taxes and a mortgage.

Cooperatives, unlike condominiums, pay their property taxes as one entity. The cooperative collects all the property taxes on the building (or buildings) and pays the tax on behalf of all the shareholders. In a condo each owner must pay his/her own property taxes.

Practically this means that the cooperative needs to split the property tax bill fairly among all shareholders. This is accomplished by including the property taxes in the cooperative fee. This is why most cooperative fees appear to be so much higher than condo fees when, in fact, they are not. If you want a true comparison to a condo fee, remember to add 1/12 of the annual tax bill to the condo fee and then compare the combined total to a co-op fee.

## Cooperative "Underlying" Mortgage Issues

Mortgage issues are usually the part that is most confusing about cooperatives.

Because the cooperative corporation owns the building, often the corporation gets a mortgage for itself. This mortgage is called the "underlying mortgage," "corporate mortgage," or even a "blanket mortgage." When a cooperative is new and first formed, the entire cost of the property is held by the cooperative itself. When the first owners buy into the cooperative they do not go to a bank and get a mortgage, they simply assume the proportion of the underlying mortgage equal to the size of the unit being purchased.

Thus, if there were a four unit building with equally-sized units just being formed, when each owner moves in he or she will assume 25% of the cooperative's underlying mortgage. If the total mortgage is \$100,000, each unit owner will assume \$25,000 of the cooperative's underlying mortgage. Easy enough to understand, right?

It gets more difficult when the first owners go to sell. Obviously each shareholder is paying off a portion of the underlying mortgage every month. Assuming that an owner has paid half the underlying mortgage off and then decides to sell, the next buyer will assume that half of the existing underlying mortgage.

Of course, the original owner will want to recover the cost he or she put into it. Assuming that the original owner only wants to break even and sells the unit for \$25,000 the new owner will assume \$12,500 in underlying mortgage and then have to pay the rest in cash OR get a second mortgage for \$12,500.

When the original owner goes to sell her property he or she will advertise the price as \$25,000. But when the new buyer decides to purchase the unit, he or she will only "pay" \$12,500 because he will assume the remaining \$12,500 of the original underlying mortgage in his co-op fee.

Imagine how confusing it can get when a unit has sold several times, or if the cooperative refinanced its underlying mortgage!

The end result is that a cooperative fee will often include a underlying mortgage payment in it. The amount of the mortgage will vary and the interest rate paid on that underlying mortgage may be higher or lower than the prevailing interest rate at the time of sale.

Unfortunately, there is no way to tell what the current underlying mortgage balance is in a cooperative unless the buyer receives a copy of a breakdown of the cooperative fee when he or she is looking to purchase.

## Cooperative "Institutional" Mortgage

One major drawback of cooperatives is that getting mortgages for them can be more difficult than for condominiums.

When a lender gives a mortgage to a buyer, instead of the entire building, it is considered an "Institutional Lender." Most institutional lenders do not lend to cooperatives at all. That's because most banks don't want to give a loan to buy stock in a corporation (which is what happens with a co-op) as opposed to providing loans to buy real property (which is what happens with a condo). Therefore, you have to go to a bank that specializes in co-op loans.

This, obviously, reduces the number of options that a buyer has. With fewer competitors, the banks that do make co-op loans may or may not charge a small premium for their loans. In the past it was common to pay 1/8 percent higher interest rate on a co-op loan. However, that practice is rare nowadays.

Additionally, each co-op maintains a list of "approved" or "recognized" lenders. Because the lender will have an interest stake in the cooperative corporation, the co-op must recognize this stake and allow the lender to have a say in what happens if an owner defaults on his or her mortgage. So each year the co-op must send financial information to lender(s) it has a recognition agreement with in order to keep that recognition agreement in place. Thus, keeping recognition agreements, in effect, costs a co-op some money. To limit its costs, most co-ops will only "recognize" two or three lenders. That means a buyer **must** use one of those lenders. The only alternative is for the buyer to pay cash to purchase the co-op.

Historically, co-op loans required a minimum 20% down payment. However, in recent years, many lenders have lowered their requirements to just 5% down. Despite that, some cooperatives still require the new buyer to put more down when purchasing in the building. These days, in Washington, most co-ops welcome buyers with as little as 5% down with open arms.

Loans available for co-ops are generally more restricted in type, which can make financing the purchase of a co-op more difficult than financing a condo. Buyers usually can only choose from 30-year fixed rate mortgages, 7-year balloon mortgages, or 1-year adjustable rate mortgages. By contrast, banks lending to condos generally offer many more loan types.

Lastly, most co-op owners generally cannot get a home equity line. There are extremely few banks that would consider giving co-op owners a home equity loan. If the lender does give them, the owner must have a very large equity stake.

## Cooperative Board Approval

Another aspect of cooperatives is that cooperative boards can choose who will live in the building and who will not. This has good points as well as bad. Some people don't like the idea of being "reviewed" by a group before being "allowed" to buy a home. But there are restrictions on the board to protect prospective buyers.

Cooperatives are bound by federal fair housing laws and cannot discriminate against people due to race, religion, sex, nationality, etc. The District of Columbia has additional protected classes including sexual orientation, personal appearance, matriculation and many more.

Cooperatives can choose people based on financial resources, criminal background and non-compliance with the rules. This means that if a person has no income and no ability to pay his cooperative fee the board can refuse to allow him into the building, thus protecting everyone's investment. Also, if a person with a criminal background wants to move into a cooperative, they can be rejected too. Lastly, if a prospective owner refuses to follow the rules of the building the board can reject him/her. Again, protecting the current owners in the building.

Condominiums cannot do this. Anyone can move in next door and if they can't afford to pay their condo fee you still can't stop them from buying! If that happens you will have to pay for their portion of the condo fee if repairs are needed, or a special assessment comes along.

Cooperatives also are usually more stringent about renting out units in the building. And since the cooperative board has total control of the building, the board can refuse to allow a fellow owner to rent his or her property. This may sound harsh, but it is actually in the best interest of the building as a whole because it keeps the investor ratio very low! (See above for details)

## Why Cooperatives are Less Expensive than Condos!

One unforeseen benefit to many cooperative buyers is that they have lower taxes. When real property is bought or sold in the District of Columbia the 2.2% transfer & recordation taxes are split between the buyer and the seller. But, since cooperatives are not real property (they are stocks), there are no transfer & recordation taxes! An owner saves on the taxes twice, once when buying and again when selling.

Also, cooperatives regular property taxes are generally lower than condominiums because the cooperative is taxed as a whole and not many small pieces of real estate. It is not uncommon for a cooperative unit to have a tax bill that is 25% of an equivalent condo.

There is one last interesting quirk of owning a co-op at this time in the District of Columbia. Because property values are increasing at such a dramatic rate property taxes are also escalating very quickly. To help alleviate the burden of these increasing taxes the City Council has passed a law limiting the maximum amount of a tax increase for an owner occupant to just 10% per year. However, when a property is sold that cap is removed and the new owner will have to pay the full amount of the tax for that property. Thus, when a buyer of a condo settles on a purchase his/her tax bill will frequently be 50% more than the amount the previous owner was paying! This doesn't happen with a co-op because a corporation owns the co-op -- when a new stock holder moves in, the ownership of the entire building doesn't change and therefore the property tax cap remains in effect. Thus co-op owners enjoy a lower property tax burden than their condo friends.

**It should be noted that cooperative owners still receive the traditional tax benefits of other property owners. They can write-off interest on mortgages and property tax just as condominium owners can.**

One last really odd part of cooperatives is that since stock is not a publicly recorded purchase cooperative owners who pay in cash do not have public record of their purchase. Thus famous (as well as infamous) people can keep their address and purchase price hidden from the public.

*This article may not be republished or distributed without the written consent of the author, Joseph Himali, a Realtor and Principal Broker of the real estate brokerage firm he founded: Best Address<sup>®</sup> Real Estate, LLC. To contact him, call 202-669-4656 or e-mail [joe@BestAddress.com](mailto:joe@BestAddress.com)*

## More Information

For more information about cooperatives, please call Joseph Himali at (202) 669-4656 or e-mail him at [joe@BestAddress.com](mailto:joe@BestAddress.com)

---

**JOSEPH HIMALI** is the principal broker and founder of Best Address® Real Estate, LLC. He was elected by his peers to serve on the 2004-2006 Board of Directors of the Greater Capital Area Association of REALTORS® (GCAAR). He also currently serves on GCAAR's Executive Committee as Treasurer. In addition, he is a board member (2005-2006) for the Washington, DC Association of REALTORS® (WDCAR). Earlier this year he was selected to serve on the Compliance Committee of the Metropolitan Regional Information Systems, Inc. (MRIS®), the largest shared computerized database containing all of the properties for sale by participating real estate brokerages in a given geographical area. In addition to playing an active role in the local REALTOR® community, Joseph devotes his energy and resources to numerous community organizations. He is a member of the Cleveland Park Historical Society, the Cleveland Park Citizens Association, the Rosedale Conservancy, the National Trust for Historic Preservation, and the DC Preservation League. A licensed REALTOR® in the District of Columbia, Maryland, and Virginia, Joseph specializes in historical, architecturally significant properties in NW Washington and on Capitol Hill. He received GCAAR's "Rookie of the Year" award in 1999 for having sold more properties than any other first year licensee in Washington, DC, and Montgomery County that year. He went on to repeatedly win GCAAR's prestigious Platinum Award for record-breaking sales. All told, in the eight years since he first became a licensed REALTOR®, he single handedly has sold more than 300 homes worth more than \$100 million -- a level of success that eludes others who have been in the industry twice as long. In addition to having received special training in historic real estate through the National Trust for Historic Preservation, he has earned both a "CRS" (Certified Residential Specialist) -- a highly regarded mark of distinction that less than 4 percent of all licensed REALTORS® in the world have achieved -- and a "GRI" (Graduate REALTOR® Institute) designation, a benchmark that less than 10 percent of REALTORS® in the DC-metro area have earned. Born and raised in DC, Joseph brings an unsurpassed knowledge of and enthusiasm for the city and its varied neighborhoods to his clients. He currently resides in Cleveland Park's historic district, where last year he and his wife wrapped up an 18-month-long renovation of their circa 1906 Shingle Style home.

**BEST ADDRESS® REAL ESTATE, LLC** is an independent, locally owned full-service, real estate brokerage firm specializing in historic properties in the nation's capital. Based in Georgetown (DC's oldest neighborhood), the firm was founded in 2004 by REALTOR® Joseph Himali to raise the bar on real estate services by providing clients with the highest level of customer service, a mastery of real estate practices, a commitment to confidentiality and above all else integrity. At Best Address® Real Estate, LLC, there are no "administrative" or "documentation" fees, and we do not engage in "standard dual agency" -- a common practice within the industry whereby the same real estate agent represents both parties (the seller and the buyer) in a single transaction. In addition, we do not participate in so-called "affinity" relationships with lenders and other service providers whereby the real estate firm has a financial interest in their clients' use of a particular service provider. A new firm built upon an old idea of providing exceptional customer service. Our motto: Best Services. Best Practices. Best Address® Real Estate, LLC.